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Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

Oct. 3, 1980

The Federal funds rate was sharply higher this week, reflecting market perception of the full extent to which the Federal Reserve has tightened its policy stance. Also contributing to the firmness in the funds market early in the week were the usual activities connected with weekend Eurodollar arbitrage and end-of-quarter window dressing, but the fundamental cause of upward rate pressure was the tightness of bank reserve positions.

The tightness had two principal sources. First, and most fundamental, the Fed's nonborrowed reserves path now appears to call for net borrowed reserves in the neighborhood of $1.5 billion. That volume of borrowing is sufficient to create a substantial spread of the funds rate over the discount rate--it is roughly consistent with the approximately 200 basis point spread we have observed this week. The second source was more technical in nature. Treasury balances rose sharply during the statement week ended Wednesday, and the rise was almost certainly in excess of Fed projections. Since an increase in Treasury balances drains reserves from banks, the open market desk entered the market to return the reserves to the banking system via RPs. The operations almost certainly were a technical response to an error in the Fed's reserve projections, and thus had no policy significance.

Some market participants, however, did not view the operation in this light, especially those who focused on the fact that from Monday through Wednesday the RPs were executed at progressively lower rates. When funds traded above 13% during Thursday, that illusion was dispelled. On Friday, the Fed arranged RPs at 11:00--unusually early--when funds were trading at 13 3/4%. The move was probably designed to reassure the market as to the extent of firmness desired.

In the weeks ahead, the Fed will be entering the market frequently to provide a seasonal addition of reserves, which should include some outright bill or note purchases. This development will be viewed favorably in some market quarters, but its fundamentally technical nature should be kept in mind. It will not signal an easing of the Fed's policy stance. Any change in policy will have to come in response to more moderate expansion of the monetary aggregates.

President Carter's criticism on Thursday of the Fed's "purely monetarist" approach to policy was predictable. Its likely influence on the Fed's willingness to stay the course in the long-haul effort to restrain monetary growth is perhaps best inferred from the fact that the Fed has moved aggressively to slow money growth little more than a month before the election. Were politics a dominant factor in Fed deliberations, an accommodative stance could easily have been adopted until November 5. The fact that it wasn't is a sure indication of the Fed's awareness that its credibility is on the line.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	10/3/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(Noon)		
Short-term loans to substantial depositors			
with highest credit rating	13.50%	13.00%	13.50%
Effective since	10/1/80		
Discount Rate at Federal Reserve Bank	11.00	11.00	11.00
Federal Funds	13.50	11.88	11.63
Repurchase Agreements	12.50	11.50	11.00
U.S. Treasury Issues			
Bills			
3 months	11.80	11.25	11.05
6 months	12.10	12.25	11.30
1 year	12.15	12.50	11.25
Coupons			
2 years	11.72	12.47	10.47
4 years	11.65	12.30	9.83
7 years	11.58	12.10	9.65
10 years	11.52	12.02	9.59
Long Bond	11.45	11.85	9.34
Negotiable Certificates of Deposit-Secondary Market			
1 month	12.80	11.80	12.35
3 months	12.90	12.10	12.55
6 months	13.00	12.65	12.80
1 year	12.80	12.75	12.60
Banker's Acceptances			
1 month	12.75	12.00	12.00
3 months	12.90	12.30	12.35
6 months	12.95	12.70	12.75
Eurodollar Deposits			
1 month	13.25	12.13	12.56
2 months	13.44	12.44	12.94
3 months	13.50	13.06	13.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	11.00	11.75	11.00
1 month	12.25	11.50	11.65
3 months	11.75	10.75	11.00
Bank Holding Companies			
1 month	12.75	11.25	11.75
Dealer Placed:			
3 months	12.63	11.88	11.88
New AA Corporate Utility Bond	13.50	13.75	10.40
Tax Exempt			
6 month Project Notes	5.40	5.45	5.25
1 year AAA Bond	6.00	6.00	NA
5 year AAA Bond	6.20	6.30	NA
20 year AAA Bond	8.60	8.60	6.20

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629